



City and County of San Francisco

Office of the Controller - City Services Auditor

FINANCIAL AUDITS DIVISION

*§ Audit Division
§ Audit Report*

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OFFICE OF THE TREASURER AND TAX COLLECTOR:

Financial Statements Audit of
the City Investment Pool
July 1, 2004, Through
June 30, 2005



January 16, 2006
05003



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CITY AND COUNTY OF SAN FRANCISCO
OFFICE OF THE CONTROLLER

Ed Harrington
Controller

Monique Zmuda
Deputy Controller

January 16, 2006

Audit Number 05003

José Cisneros, Treasurer
Office of the Treasurer and Tax Collector
City Hall, Room 140
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102-4638

Dear Mr. Cisneros:

The Office of the Controller presents its financial audit report of the Statement of Net Assets and Statement of Changes in Net Assets of the City and County of San Francisco (City) Investment Pool (Pool) held by the Office of the Treasurer and Tax Collector (Treasurer) as of June 30, 2005. These basic financial statements present the total cash and investments, and related activity under the control and accountability of the City's Treasurer.

We found that the basic financial statements referred to above present fairly, in all material respects, the financial position of the City's Pool as of June 30, 2005, and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America. We also found that the Treasurer complied with the investment requirements in the California Government Code, Sections 27130 through 27137, and with the City's investment policy.

Respectfully submitted,

Ed Harrington
Controller



CITY AND COUNTY OF SAN FRANCISCO

OFFICE OF THE CONTROLLER
FINANCIAL AUDITS DIVISION

Ed Harrington

Controller

Monique Zmuda

Deputy Controller

INDEPENDENT AUDITOR'S REPORT

San Francisco Board of Supervisors
City and County of San Francisco

We have audited the accompanying basic financial statements consisting of the Statement of Net Assets and the Statement of Changes in Net Assets of the City and County of San Francisco Investment Pool (Pool) under the control and accountability of the Office of the Treasurer and Tax Collector (Treasurer) of the City and County of San Francisco (City), as of June 30, 2005. These financial statements are the responsibility of the Pool's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statement is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statement. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the total cash on hand, cash in bank, investments, and related activity under the control and accountability of the Treasurer. This report is intended for the purpose of providing information as required by Sections 26920(b) and 27134 of the California Government Code and Section 10.6-3 of the San Francisco Administrative Code. Our audit does not include an evaluation of the performance of the Treasurer's investment portfolio.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Pool as of June 30, 2005, and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 1, the Treasurer has implemented new investment reporting requirements as required by the provisions of GASB Statement No. 40, *Deposit and Investment Risk Disclosures – an amendment of GASB Statement No. 3* as of June 30, 2005.

In accordance with *Government Auditing Standards*, we have also issued a report dated January 16, 2006, on our consideration of the Treasurer's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and the City's investment policy. The purpose of that report is to describe the scope of our testing on internal control over financial reporting and compliance and the results of that

testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

However, because the City's Controller has some responsibility for the Pool, we were not entirely free of organizational impairments to independence in conducting our work. Accounting standards require we disclose this impairment. We limited our review to those areas specified in Note 1.

This report is intended solely for the information and use of the Board of Supervisors, the Treasurer's management, and others within the organization and is not intended to be and should not be used by anyone other than these specific parties. However, this report is a matter of public record and its distribution is not limited.

CONTROLLER'S FINANCIAL AUDITS DIVISION



Noriaki Hirasuna, CPA
Director

January 16, 2006

Staff: Elisa Sullivan, Audit Manager
Leon Valle, Jr.
Wing Hang Yiu

CITY AND COUNTY OF SAN FRANCISCO INVESTMENT POOL
STATEMENT OF NET ASSETS
JUNE 30, 2005

	Total
ASSETS	
Cash	
Cash on Hand	\$ 6,780
Cash on Hand	<u>27,997,567</u>
Total Cash	28,004,347
Investments at Fair Value	
U.S. Treasury Bills	682,030,240
U.S. Treasury Notes	54,790,625
Federal National Mortgage Association Discount Notes (FMNA Discount Notes)	514,815,883
Federal Home Loan Bank Discount Notes (FHL Discount Notes)	470,996,630
Federal Home Loan Mortgage Corporation Discount Notes (FMC Discount Notes)	445,978,557
Commercial Paper	377,887,968
Negotiable Certificates of Deposit	357,974,587
Public Time Deposit	<u>100,000</u>
Total Investments	2,904,574,490
Accrued Interest Receivable	<u>11,286,973</u>
Total Assets	\$ 2,943,865,810
LIABILITIES	
Outstanding Checks	<u>\$ 105,176,100</u>
Total Liabilities	\$ 105,176,100
NET ASSETS	\$ 2,838,689,710

See Accompanying Notes to the Basic Financial Statements

**CITY AND COUNTY OF SAN FRANCISCO INVESTMENT POOL
STATEMENT OF CHANGES IN NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2005**

	Total
<u>ADDITIONS</u>	
Additions to Investment Pool	\$ 57,531,989,664
Investment Income:	
Net Decrease in Fair Value of Investments	(585,184)
Interest	<u>58,570,204</u>
Total Investment Income	<u>57,985,020</u>
Total Additions	57,589,974,684
<u>DEDUCTIONS</u>	
Deductions from Investment Pool	\$ 56,925,876,244
Distributions to Participants	47,430,818
Administrative Expenses	<u>5,287,829</u>
Total Deductions	56,978,594,891
Change in Net Assets	611,379,793
Net Assets, Beginning of Year	<u>2,227,309,917</u>
NET ASSETS, END OF YEAR	\$ 2,838,689,710

See Accompanying Notes to the Basic Financial Statements

NOTES TO THE BASIC FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

The City and County of San Francisco (City) Investment Pool (Pool) is a local government investment pool with approximately \$2.8 billion in net assets as of June 30, 2005. As the banker, tax collector, collection agent, and investment officer for the City, the Office of the Treasurer and Tax Collector (Treasurer) manages the Pool on behalf of most funds of the City and external participants. Investments made by the Treasurer are regulated by the California Government Code and by the City's investment policy approved annually by the City's Treasury Oversight Committee and the Board of Supervisors.

The Statement of Net Assets and the Statement of Changes in Net Assets are prepared using the economic resources measurement focus and the accrual basis of accounting. Earnings on investments are recognized as revenue in the period in which they are earned and administrative costs are recognized as expense when incurred, regardless of the timing of cash flows. Pool participants' cash balances and withdrawals are based on book value while investments are reported at fair value. These basic financial statements present only the cash on hand, cash in bank, investments, and related activity under the control and accountability of the Treasurer of the City. The financial statements are not intended to present fairly the financial position and results of operations of the Treasurer or of the City.

In the current fiscal year, the Treasurer implemented the Governmental Accounting Standards Board (GASB) Statement No. 40, *Deposit and Investment Risk Disclosures – an amendment of GASB Statement No. 3*. This statement adds to and changes certain financial statement disclosure requirements for cash and investments of local governments.

The table below identifies the investment types that are authorized by the City's investment policy. The table also identifies certain provisions of the City's investment policy that address interest rate risk, credit risk, and concentration of credit risk. The investment policy provides additional restrictions related to these investments. Investments held by the Treasurer during the year did not include repurchase agreements or reverse repurchase agreements.

NOTES TO THE BASIC FINANCIAL STATEMENTS

TABLE 1

Types of Investments Authorized
By the City's Investment Policy

Authorized Investment Type	Maximum Maturity	Maximum Percentage of Portfolio	Maximum Investment in One Issuer
U.S. Treasury Obligations	N/A	None	None
U.S. Agency Securities	N/A	60%	None
Commercial Paper	180 days	40%	10%
Negotiable Certificates of Deposit	5 years	30%	None
Public Time Deposit	1 year	None	None
Public Demand Accounts	N/A	None	None
Bankers Acceptances	180 days	40%	30%
Repurchase Agreements	30 days	None	None
Reverse Repurchase Agreements	45 days	None	\$75M

The Treasurer's Pool includes dedicated investment funds. The dedicated investment funds represent restricted funds and relate to bond issuance of the City's enterprise funds and the City's general fund's cash reserve requirement. The Pool also includes both involuntary and voluntary participation from external entities. The State of California statutes require certain special districts and other governmental entities to maintain their cash surplus with the Treasurer. The San Francisco Unified School District (school district), the San Francisco Community College District (community college district), and the City are involuntary participants in the City's Pool. As of June 30, 2005, involuntary participants accounted for approximately 91 percent of the Pool. Voluntary participants accounted for 9 percent of the Pool. Further, the school district, community college district, and the Trial Courts of the State of California are external participants of the City's Pool. At June 30, 2005, \$321 million was held on behalf of these external participants. The total percentage share of the City's Pool that relates to these three external participants is 11 percent. Internal participants accounted for 89 percent of the Pool. During the fiscal year ended June 30, 2005, the Treasurer has not entered into any legally binding guarantees to support the participant equity in the Pool. Further, the Pool is not registered with the SEC as an investment company.

All investments are carried at fair value in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. The fair value of pooled investments is determined annually and is based on current

NOTES TO THE BASIC FINANCIAL STATEMENTS

market prices. The fair value of participants' position in the Pool is the same as the value of the Pool shares. The method used to determine the value of participants' equity withdrawn is based on the book value of the participants' percentage participation at the date of such withdrawal. In the event that a certain fund overdrafts its share of pooled cash, the overdraft is reported as a due to the general fund.

Income from pooled investments is allocated at month-end to the individual funds or external participants based on the fund or participant's average daily cash balance in relation to the total pooled investments. City management has determined that the investment income related to certain funds should be allocated to the general fund. On a budget basis, the interest income is recorded in the City's general fund. On a generally accepted accounting principles (GAAP) basis, the income is reported in the fund where the related investments reside. A transfer is then recorded to transfer an amount equal to the interest earnings to the general fund.

It is the City's policy to charge interest at month end to those funds that have a negative average daily cash balance. In certain instances, City management has determined that the interest expense related to the fund should be allocated to the City's general fund. On a budget basis, the interest expense is recorded in the general fund. On a GAAP basis, the interest expense is recorded in the fund and then a transfer from the general fund for an amount equal to the interest expense is made to the fund.

The types of investments made during the year were substantially the same as those held as of June 30, 2005. Fair value fluctuates with interest rates, and increasing rates could cause fair value to decline below original cost. City management believes the liquidity in the portfolio is sufficient to meet cash flow requirements and to preclude the City from having to sell investments below original cost for that purpose.

In accordance with California Government Code, Section 27136, any requests from agencies to withdraw funds from the investment pool for purposes other than cash flow, such as for external investing, is subject to the consent of the Treasurer. Those requests are subject to the Treasurer's consideration of the stability and predictability of the pooled investment fund, or the adverse effect on the interests of the other depositors in the pooled fund.

NOTES TO THE BASIC FINANCIAL STATEMENTS

Withdrawals are at the value shown on the Office of the Controller's books as of the date of withdrawal.

Receivables consist of interest accrued on investments. The payables consist of outstanding checks, 44 percent of which represent outstanding checks of the school district.

2. Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the Treasurer manages its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations.

Investments include investments that are insured or registered or securities held by the City or its agent in the City's name. Information about the sensitivity to the fair values of the Treasurer's investments to market interest rate fluctuations is provided by the following table, which shows the distribution of the Treasurer's investments by maturity.

TABLE 2

Pooled Investments by Maturity (in thousands)

Investment Type	Interest Rates	Maturities	Par Value	Fair Value (a)	Investment Maturities (in Months)				
					Under 1	1-6	6-12	12-36	36-60
U.S. Treasury Bills	2.64%-3.09%	7/7/05-11/25/05	\$690,000	\$682,030	\$287,571	\$394,459			
U.S. Treasury Notes	3.50%-3.63%	11/15/06-6/15/10	55,000	54,791					\$54,791
FNMA Discount Notes	2.97%-3.19%	7/11/05-10/05/05	518,000	514,816	149,173	365,643			
FHL Discount Notes	2.91%-3.13%	7/7/05-8/26/05	474,000	470,996	174,390	296,606			
FMC Discount Notes	2.95%-3.23%	7/5/05-10/18/05	450,000	445,979	170,968	275,011			
Commercial Paper	3.04%-3.29%	7/5/05-8/29/05	380,000	377,888	164,291	213,597			
Negotiable C.D.'s	3.09%-3.31%	7/11/05-8/30/05	358,000	357,974	198,993	158,981			
Public Time Deposit	3.00%	7/16/05	100	100	100				
Total Investments:			\$2,925,100	\$2,904,574	\$1,145,486	\$1,704,297			
									\$54,791

(a) The fair value amounts do not include accrued interest of \$10,876,562, \$670,697 of which is fixed assets accrued earnings.

3. Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized

NOTES TO THE BASIC FINANCIAL STATEMENTS

statistical rating organization. Presented below is the minimum rating required by the California Government Code and the City's investment policy and the actual rating as of June 30, 2005 for each investment type.

TABLE 3

Investment Type	Minimum Legal Rating	Standard & Poor's Rating	Total Investment Portfolio
U.S. Treasury Bills	N/A	A-1+	24%
U.S. Treasury Notes	N/A	A-1	2%
U.S. Agencies	N/A	A-1+	18%
U.S. Agencies	N/A	A-1	31%
Commercial Paper	A-1	A-1	13%
Negotiable C.D.'s	N/A	A-1+	12%

In addition, the Treasurer's investment in the public time deposit is not rated. The City's investment policy contains no limitations on the amount that can be invested in any one issuer beyond that stipulated by the California Government Code. U.S. Treasury and Agency securities are not subject to these limitations. Investments in any one issuer that represent 5 percent or more of the total investment pool are in Federal National Mortgage Association Discount Notes, Federal Home Loan Bank Discount Notes, Federal Home Loan Mortgage Corporation Discount Notes, commercial paper, and negotiable certificates of deposit. These investments represent 18 percent, 16 percent, 15 percent, 13, and 12 percent, respectively, of the City's investments. Investments in commercial paper are with Bank of America, U.S. Bank, Deutsche Bank, and U.S. Bancorp, with Bank of America representing 11 percent of the total 13 percent investment in commercial paper. Negotiable certificates of deposit are with Wells Fargo Bank, J.P. Morgan, Union Bank, and Bank of America, with Wells Fargo Bank representing 7 percent of the total 12 percent investment in negotiable certificates of deposit.

4. Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party.

NOTES TO THE BASIC FINANCIAL STATEMENTS

The California Government Code and the City's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments; however, it is the practice of the Treasurer that all investments are insured, registered, or held by the Treasurer's custodial agent in the City's name.

The California Government Code requires California banks and savings and loan associations to secure the City's deposits not covered by federal deposit insurance by pledging government securities as collateral. The fair value of pledged securities must equal at least 110 percent of the type of collateral authorized in California State Government Code, Section 53651 (a) through (i) of the City's deposits. The collateral must be held at the pledging bank's trust department or another bank, acting as the pledging bank's agent, in the City's name. The investment policy states that mortgage-backed collateral will not be accepted. At June 30, 2005, all of the banks with funds deposited by the Treasurer secure deposits with sufficient collateral.

5. Investment Policy

The City's investment policy addresses the soundness of financial institutions in which the City will deposit funds, types of investment instruments as permitted by the California Government Code, and the percentage of the portfolio which may be invested in certain instruments with longer terms to maturity. The objectives of the policy, in order of priority, are preservation of capital, liquidity, and yield. The City has established a Treasury Oversight Committee, comprised of various City officials and representatives of agencies with large cash balances, to monitor and review the management of public funds maintained in the investment pool in accordance with Sections 27130 to 27137 of the California Government Code. The Treasurer prepares and submits a comprehensive investment report to the members of the oversight committee and the investment pool participants every month. The report covers the type of investments in the pool, maturity dates, par value, actual cost, and fair value.

Although the California Government Code and the City's investment policy do not limit the amount of City funds that may be invested in treasury bills and treasury notes, the investment policy requires the consideration of the City's anticipated cash requirements when purchasing treasury notes of longer maturities. Also, treasury notes with maturities that exceed five years are restricted to a maximum of 10 percent of the total portfolio at the time of purchase. In addition, purchases of treasury bonds are

NOTES TO THE BASIC FINANCIAL STATEMENTS

subject to an analysis of cash requirements and restricted to a maximum of five percent of the total portfolio at the time of purchase.

Further, the California Government Code does not limit the amount of City funds that may be invested in federal agency instruments. However, the City's investment policy requires that investments in federal agencies should neither exceed 60 percent of the total portfolio at the time of purchase nor have a weighted average maturity in excess of 270 days. If it exceeds 270 days, the total should not exceed 30 percent of the total par value of the portfolio. The investment policy also limits each type of agency instrument.

The City's investment policy also limits the purchase of negotiable certificates of deposit to the five largest domestic commercial banks that have demonstrated profitability in their most recent audited financial statements at the time of purchase. In addition, the investment policy requires that public time deposits be made only at approved financial institutions with at least one full service branch within the geographical boundaries of the City, and that they yield a minimum of 0.125 percent higher than equal maturity U.S. Treasury instruments. The investment policy restricts exposure to \$100,000 for all savings institutions and requires that each deposit be fully guaranteed by the Federal Deposit Insurance Corporation (F.D.I.C.). The investment policy also requires that commercial bank deposits be made on a competitive basis with risk exposure based on financial statements and related information gathered on each individual bank.

Also, the California State Government Code requires that the Treasurer purchase only domestic commercial paper with maturities not to exceed 270 days and that the issuer must be rated in the highest ranking by at least one of the national rating agencies. However, the Treasurer's investment policy is more restrictive in that it requires that the Treasurer purchase only domestic commercial paper with maturities not to exceed 180 days.

The Treasurer also holds for safekeeping bequests, trust funds, and lease deposits for other city departments. The bequests and trust funds consist of stocks and debentures. Those instruments are valued at par, cost, or market value at the time of donation. The following table summarizes the bequests, trusts, and lease deposits held by the Treasurer.

NOTES TO THE BASIC FINANCIAL STATEMENTS

TABLE 4

Bequests, Trusts, and Lease Deposits Held by the Treasurer

Safekeeping Items	Amount
Bequests and Trusts	
San Francisco General Hospital	
Augusto Brunetti Bequest	\$ 166
Laguna Honda Hospital	
William L. Lenahan	207,478
Marie Lewis Gift Fund	72,336
Hazel I. Putnam	1,227
Miscellaneous Gift Fund	118,863
Recreation and Park Department	
Gilliland Bequest	182,364
Mildred Martin Bequest	7,182
Department of Human Services	
Mary Arcuri Account	2,163
Federal Home Loan Bequest	392
War Memorial	
P.P.I.E. Scholarship	5,000
Total Bequest and Trust Funds	\$ 597,171
Total Lease Deposits	\$ 25,658,046
Total Safekeeping Items	\$ 26,255,217



CITY AND COUNTY OF SAN FRANCISCO
OFFICE OF THE CONTROLLER
FINANCIAL AUDITS DIVISION

Ed Harrington
Controller
Monique Zmuda
Deputy Controller

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT
OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

We have audited the basic financial statements, consisting of the Statement of Net Assets and the Statement of Changes in Net Assets, of the City and County of San Francisco Investment Pool (Pool) under the control and accountability of the Office of the Treasurer and Tax Collector (Treasurer) of the City and County of San Francisco (City) for the fiscal year ended June 30, 2005, and have issued our report thereon dated January 16, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Treasurer's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operations that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Treasurer's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and the Treasurer's investment policy, noncompliance with which could have a direct and material effect on the determination of the financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

Noriaki Hirasuna, CPA
Financial Audits Director
January 16, 2006

cc: Mayor
Board of Supervisors
Civil Grand Jury
Budget Analyst
Treasury Oversight Committee
Public Library



